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UNCLAS SECTION 01 OF 03 MANILA 005983

SIPDIS

STATE FOR EB/IFD/OIA; EAP/MTS
STATE PASS USTR FOR BWEISEL AND DKATZ
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TREASURY FOR OASIA FOR AJEWELL
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E.O. 12958: N/A
TAGS: ECPS EINV ETRD ECIN RP APEC
SUBJECT: TELECOM UPDATE: GRP ENCOURAGES INTERNET TELEPHONY

REF: MANILA 2282

SUMMARY

¶1. The National Telecommunications Commission (NTC) issued recent rulings lowering entry barriers to encourage the development of Voice Over Internet Protocol (VoIP) services. The decisions should reduce international rates but will have less impact on lucrative cellular services, which have eclipsed fixed line services to drive industry growth. Incumbent telecom firms have reacted by threatening lawsuits, aggressively marketing broadband and sharply lowering international rates for broadband subscribers. Analysts expect incumbents to demand high interconnection fees in order to limit competition from VoIP service providers, particularly in the termination of incoming international calls. The NTC plans to implement a stronger competition policy to limit anti-competitive behavior by dominant firms. USAID has assisted the NTC in drafting the VoIP rulings and continues to support its enhanced regulatory role. End Summary.

BOOMING CELLULAR MARKET

¶2. The telecommunications sector has grown sharply since 2000, primarily through rapid expansion of mobile phone services. Cellular subscribers increased from 6.4 million in 2000 to 32.9 million in 2004 with two main operators, Smart and Globe, accounting for 14.6 million and 12.5 million subscribers, respectively. Roughly half of wireless revenues come from text messaging, immensely popular in the Philippines due to its low cost. Optel telecommunications analyst Gary Anonuevo estimated that 99% of cellular revenues come from pre-paid cell phone users who spend an average of 350 pesos ($6.50) per month for prepaid cards.

¶3. As cellular services have become more convenient and affordable, the relative importance of fixed line services has declined. As of 2004, there were 6.5 million fixed phone lines, including 2.9 million with the dominant carrier, the Philippine Long Distance Telephone Company (PLDT), which owns Smart. PLDT/Smart reported that its fixed line division provided 39% of revenues but only 6% of profits in 2004 after losing money in 2003. According to the NTC, the four dominant carriers reported 42% average annual growth in wireless revenues from 2000-2004 compared with 1.3% average annual growth in fixed line revenues over the same period.

¶4. VoIP services are already available to broadband users, but Internet penetration remains limited to less than 2% of the population. The NTC estimates that Internet subscriptions rose from 350,000 in 1999 to 1,200,000 in ¶2004.

VOIP CLASSIFIED AS A "VALUE ADDED SERVICE"

¶5. NTC's recent decision to classify VoIP as a "value-added service" (VAS) allows companies to offer VoIP services without going through the long and arduous process of obtaining a congressional franchise. The ruling removes uncertainty over the status of VoIP services that were not foreseen and categorized by the 1995 Public Telecommunications Policy Act (RA 7925). This law limits the provision of traditional telephone services to "Public Telecommunications Entities" (PTEs) holding a congressional franchise, but exempts VAS providers from the franchise requirement.

¶6. NTC registration guidelines established additional requirements for VoIP service providers, notably a 5 million peso performance bond, a 10 million peso minimum capital requirement and, most importantly, a valid interconnection agreement. NTC Common Carrier Department Director Edgardo

Cabarios explained that RA 7925 has no provisions to penalize telecommunication service providers, so the bond is intended to protect consumers from "fly-by-night" companies. He underscored the need for NTC to balance its role in protecting consumers with its interest in ensuring market access and competition.

DOMINANT FIRMS REACT

¶7. Several incumbent PTEs vowed to challenge the NTC rulings in court, arguing that VoIP service providers will have lower overhead costs and can charge lower rates than existing companies that invested heavily in fixed and wireless networks. Several telecom analysts doubted the legal merits of these lawsuits but portrayed them as delaying tactics. ATT Managing Director Romulo Carlos suggested the incumbents may use legal threats to pressure the NTC into accommodating their interests on the important issue of interconnection rates. As of December 14, Cabarios reported that the NTC had not been formally notified of any legal challenges to its decisions. If the lawsuits do gain traction, two proposed bills (House Bill 3476 and House Bill 3644) would strengthen the NTC's authority to define and regulate VoIP services.

¶8. Dominant PTEs are most concerned about the threat VoIP services pose to their profitable international direct dialing (IDD) services. According to Optel analysts, U.S. firms have offered termination rates of approximately 1.5 cents per minute for several years, but Philippine firms have maintained outgoing rates of 40 cents per minute (for a profit margin exceeding 90%) until the VoIP decision. Termination fees are particularly important since the volume of incoming calls is ten times the volume of outgoing calls and termination fees for VoIP-mediated calls are easier to control than interconnection fees for outgoing calls. Collusion to raise termination rates led to a dispute with US carriers in 2003, reported in reftel.

¶9. Incumbents have reacted to this threat by stepping up their marketing of broadband services and sharply reducing international rates for broadband subscribers. For example, PLDT announced a new International Direct Dialing (IDD) service available to DSL subscribers at 10 cents per minute, 75% lower than its usual international rate. Globe countered with a similar service offering rates as low as 5 cent per minute. Globe also reduced standard rates from 40 cents to 10 cents/min for regular outbound calls. Former PLDT/Smart Financial Advisor Peter Lawrence explained that PLDT plans to promote VoIP services while increasing broadband subscriptions to compensate for the expected decline in fixed line revenues. Globe Telecom, the country's second landline/cellular provider recently purchased U.S. VoIP technology to expand their broadband service offering and broaden their revenue base.

¶10. Lower international rates for VoIP services should provide substantial benefits to U.S. consumers and U.S. firms. The Philippines is the third-largest destination for outgoing international calls from the U.S. and the estimated four million Philippines-born Americans stand to gain from lower international rates of VoIP service providers. The VoIP ruling has attracted U.S. firms interested in joint ventures with local VoIP providers to offer pre-paid cards.

INCUMBENTS MAY SET INTERCONNECTION RATES

¶11. Industry analysts expect incumbent PTEs to impose high interconnection rates to delay the spread of VoIP services. Lawrence noted that interconnection rates should account for the higher level of investment by incumbent PTEs in fixed and cellular networks. Observers point out that PLDT/Smart can pressure other firms to maintain high interconnection rates by threatening to raise connection fees and limit access to its network.

¶12. The VoIP guidelines allow the NTC to intervene to impose interconnection agreements if VoIP providers and incumbent PTEs cannot agree on rates. Neither Carlos nor Optel analysts believe that the NTC will be aggressive in forcing incumbents to lower rates. Cabarios acknowledged the danger of collusion among PTEs to limit connectivity for VoIP service providers but he underscored the NTC's aim to allow market forces to determine rates. He pointed to NTC moves to increase broadband frequencies in order to further promote competition for interconnection rates.

¶13. The NTC signaled its willingness to regulate interconnection rates when it issued a "Consultative Document on the Development of a Competition Policy Framework" for the ICT sector. The NTC estimates that two main fixed line carriers account for three quarters of this

market while two main cellular carriers control 96% of the wireless market. It criticized the "unregulated price-squeezing behavior of dominant licensees" and expressed concern that dominant firms could use similar strategies to impede the spread of VoIP services. The NTC has proposed to impose "Significant Market Power" obligations on dominant firms, establish unbundling requirements, allow the resale of services and enhance NTC's role in ensuring reasonable interconnection rates.

COMMENT

¶14. The NTC's progressive stance should encourage competition and lower international rates, but incumbent firms are likely to use their control of local connectivity to delay the spread of VoIP services. The NTC can further ensure the spread of VoIP services by pursuing the more active regulatory role outlined in its draft competition policy. Although VoIP services should reduce traditional fixed line revenues for dominant firms, they will have less impact on cellular services where profits and growth are highest. USAID continues to support the NTC as it consults with stakeholders to strengthen its regulatory role.

¶15. The VoIP ruling, explanatory memo and guidelines are posted on the NTC website at: www.ntc.gov.ph.

JONES